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E.O. 12958: DECL: 06/20/2016  
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SUBJECT: STORMY DAYS AT EADS AND AIRBUS

Classified By: Karl W. Hofmann, Deputy Chief of Mission,  
for reasons 1.4b and d.

#### SUMMARY

¶1. (SBU) The furor surrounding EADS, recent plunge in the stock market, following revelations last week of further delays in Airbus A380 deliveries (see Paris Points of June 14, 15, 16), has plunged Airbus and its mother company EADS into one of the deepest crises in their history. Revelations June 15 that EADS co-President Noel Forgeard and other EADS/Airbus officials profited from EADS stock sales in March, when the stock price was riding historic highs, have only added to the controversy, and French stock regulators are investigating the propriety of the sales.

¶2. (SBU) Ironically, some EADS and Airbus managers profited, while major shareholders BAE Systems, the Lagardere Group and Daimler-Chrysler watch their own planned sale profits evaporate with the fall in EADS share price. Arnaud Lagardere, co-chair of the EADS Board, will meet with his German counterpart and other EADS Board members in Germany early this week. Lagardere had opposed Forgeard's appointment as EADS co-President last year, but was overruled by the direct intervention of French President Chirac. Stock market regulators and the press will be looking hard to see who else may have profited by timely EADS stock sales this spring. Meanwhile, serious questions are being raised about both EADS, Franco-German management structure, and its politically-correct production sharing arrangements.

#### BACKGROUND - AN UNWIELDY SUPERSTRUCTURE

¶3. (U) Boeing, s major rival in long-haul commercial aircraft production is Toulouse-based Airbus Industries. Airbus is 80%-owned by EADS (European Aeronautic Defense and Space Company), with the remaining 20% controlled by the British defense contractor BAE Systems. BAE has recently indicated its intention to sell its stake in Airbus back to EADS.

¶4. (SBU) EADS in turn is controlled by the German Daimler-Chrysler corporation (30%), a French consortium SOGEADE (30% - split evenly between the French government and the private Lagardere Group), and the Spanish state holding company SEPI (5%). The remaining 35% of EADS stock is traded publicly. While Airbus counts for three-fourths of EADS activity, the corporation also has helicopter, space and defense/security activities. The controlling Franco-German ownership interest has largely ruled the corporate decision-making process.

¶5. (SBU) The multi-national European character of both EADS and Airbus has resulted in a politically-correct balance in both the management control structure and production infrastructure. EADS has two co-CEOs, French (Noel Forgeard) and German (Tom Enders) with roughly equal powers, and the

EADS Board has two co-directors, French (Arnaud Lagardere) and German (Manfred Bischoff). Airbus is currently headed by a German CEO, Gustav Humbert, who replaced French predecessor Noel Forgeard.

#### PROBLEMS WITH BOTH THE A380 AND PROPOSED A350

¶6. (U) After spending much of the past decade catching -- and, in the past year, even surpassing -- rival Boeing, Airbus is facing serious problems in producing both its flagship A380 superjumbo and its proposed A350 competitor to Boeing's new 787 Dreamliner<sup>8</sup>. The proposed A350 has been criticized by potential customers as not new enough<sup>8</sup>.

They argue that the current Airbus plan is largely a redesigned, upgraded A330/A340 with new wings, insufficient to meet the market's demand for a long-range, fuel efficient, medium-capacity aircraft. As a result, Boeing is building a huge lead in this market segment, and Airbus will reportedly announce in July a fully redesigned A350 (likely to be renamed the A370), with the need for an additional 3-5 billion euros in development costs.

¶7. (U) Meanwhile, production problems have plagued the new A380 superjumbo jetliner. Originally scheduled for initial deliveries in mid-2006, the launch was pushed back to end-2006. Airbus still expects to deliver its first A380 to Singapore Airlines on schedule, but shocked financial markets and the industry June 13 when it announced it would likely deliver only 7-9 A380 aircraft in 2007, instead of the planned 20-25. Production delays -- focused on electrical harnessing systems -- will extend into 2010. Airbus profits could be cut by some 500 million dollars annually through ¶2010.

#### FINANCIAL MARKETS SPANK AIRBUS PARENT EADS

¶8. (SBU) Financial markets reacted quickly to the Airbus announcement, pummeling EADS stock the next day. EADS fell 26.3 percent on June 14 on the Paris CAC-40, wiping out in a single day about 5.5 billion euros in valuation, one of the largest single-day corporate tumbles in history. The situation has reopened publicly long-standing questions about whether EADS, and Airbus, bifurcated management structures and shared production methods make long-term sense.

#### STOCK SALES REVELATIONS ADD FUEL TO THE FIRE

¶9. (SBU) EADS, spectacular stock slide was followed June 15 by revelations that EADS co-CEO Noel Forgeard and a number of other EADS and Airbus officials had sold EADS stock in March 2006, when the stocks were at historic highs. Some have questioned whether Forgeard and other senior officials could have been unaware of the growing A380 production problems and their implications for future market valuations.

Forgeard, for his part, insists that the seriousness of the production delays only began to be known in April, and that even then the problems appeared surmountable. The French stock market regulator AMF (Autorite des Marches Financiers) has launched an inquiry into the stock sales.

#### WHO GETS HURT?

¶10. (C) The list of interests hurt by this crisis is impressive:

BAE Systems stands to lose significant value in its effort to sell its 20% stake in Airbus. Rothschild has reportedly been appointed to mediate between BAE and EADS in determining a fair value for the BAE interest.

Daimler-Chrysler and the Lagardere Group. Both Daimler and the Lagardere Group have long indicated their intention to reduce and eventually divest their EADS holdings, to focus on their core activities (respectively, automotive and media interests). The companies had announced several months ago their intention to each sell a 7.5% stake in EADS, most likely on European exchange markets. The carefully-crafted plan would keep German and French equity in EADS on an equal

footing (22.5% respectively). Both companies, prime movers in EADS decision-making, now face the prospect of significantly-reduced profits from those sales, and representatives of both groups have claimed to have been kept in the dark by both EADS and Airbus management of the extent of the production problems.

Franco-German Industrial Cooperation. EADS/Airbus is the jewel of Franco-German industrial cooperation, a relationship that has always rested more easily with Paris than with Berlin. Tensions have often been high in major decisions affecting control of Airbus and EADS, never more so than 18 months ago, when both German interests and Lagardere CEO Arnaud Lagardere vigorously opposed the nomination of then-Airbus President Forgeard to replace EADS co-CEO Philippe Camus. Forgeard's appointment came only at the insistence of French President Jacques Chirac. (Comment. An AMF official suggested to Economic Minister-Counselor last week that regulators also will take a close look at whether private individuals close to Forgeard were selling EADS stock earlier this spring. End Comment.)

Airbus Customers. Production delays in the A380, and continued delays in the design of the proposed A350 will impose costs on long-time and new Airbus customers. Some market analysts are watching airlines in the Gulf -- major Airbus customers -- carefully, to see whether they seek to get out of contract deals with Airbus. At a minimum, many airlines will seek compensation from Airbus for the delays.

#### COMMENT: NEXT STEPS

¶11. (C) The EADS Board is expected to gather in Germany this week to consider the situation. Much will depend on the outcome of investigations into stock-trading by senior EADS and Airbus officials. However, we would be surprised if regulators come up with clear evidence of wrongdoing. Similarly, while EADS, complicated management structure and Airbus, &production by committee methods may be criticized, European industrial politics and political realities argue against any significant changes at this point. Airbus officials will be pressed to lay out a clear strategy for getting the A380 project back on track, and getting a viable A350 project off the drawing boards. Domestically, in France, the crisis will provide another chink in President Chirac's much-abused armor, but probably little real drama as France nears its summer slowdown. Chirac is closely identified with the EADS/Airbus project, and &his man Noel Forgeard is at the center of the storm.

¶12. (C) For the moment, the only clear winner appears to be Boeing. Boeing's impressive commercial numbers in recent months stand in stark contrast to Airbus, growing list of dissatisfied customers. The current crisis swirling around Airbus can only slow further the company's efforts to launch a competitor to the Boeing 787 Dreamliner. What is unclear, however, is the impact of the crisis on Airbus, potential use of government launch aid to develop the A350. Presumably, the current difficulties will make rapid development of a revamped A350 a top priority, and Airbus, reduced cash flow with A380 delays will make launch aid all the more important. While Boeing stands to benefit commercially in the near term from Airbus, woes, those same troubles may make a negotiated solution to the Airbus/Boeing WTO dispute all the more difficult.

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